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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

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# No. 31

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AMERICAN UNITED MUTUAL LIFE INSURANCE COMPANY,
*Petitioner,*

*vs.*

CITY OF AVON PARK, FLORIDA,
*Respondent.*

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## PETITION FOR REHEARING

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ROBERT J. PLEUS,
*Attorney for Respondent.*

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AMERICAN UNITED MUTUAL LIFE INSURANCE COMPANY,
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## PETITION FOR REHEARING

To the opinion and decision of this Court under date of November 25, 1940, Respondent, City of Avon Park, Florida, files this its Petition for Rehearing.

At the outset, Respondent desires to impress upon the Court that it has no quarrel with the imposition by a Court of Equity of the highest standards of business ethics, fair dealing and moral practice; however, it respectfully submits that because of the matters hereinafter set forth the opinion and decision of this Court will have a terrific impact upon bankruptcy reorganizations of every nature, will render nugatory in

many of their aspects the practical operation of the remedial reorganization statutes passed by the Congress, and above all, will now place in the hands of the recalcitrant minorities the very weapons which it was the design and object of the Congress to take from them in the passage of these Acts. The result of the opinion and decision of this Court upon Respondent is to deprive it and its taxpayers of the benefits of Chapter IX of the Bankruptcy Laws of the United States, as amended, inasmuch as a single creditor has a sufficient volume of securities to prevent the operation of the Act.

It is respectfully submitted that in its opinion and decision of November 25, 1940, this Court overlooked and failed to consider the following:

1. That Chapter IX is fundamentally predicated upon, and is inoperative without, absolute cooperation and identity of interest and objective existing between the unit and the requisite majority of its creditors. The unit is helpless to even institute the proceedings without fifty-one per cent of its creditors already seeing eye to eye with it, and confirmation may not be had until sixty-six and two-thirds per cent of the holders in volume of the indebtedness affected are in agreement. Thus, the operative effect of the Act is made possible only by cooperative effort between the unit and the majority of its creditors.

2. That there is a specific distinction in the Act itself between a creditor who is merely a creditor, and a creditor who renders special service not rendered by other creditors and for which it is entitled to just compensation; and in holding that in passing upon the compensation to be received by a creditor to determine whether such is reasonable, the Court must take into consideration the aggregate of all the emolu-

ments accruing to such creditor, or the aggregate benefits flowing to it, the total of which must be reasonable, this Court fails to distinguish between a bona fide creditor merely and one who, though a creditor, has rendered a special service for which it is entitled to compensation; and likewise, such holding flies in the very face of Section 83 (b) of the statute itself, which grants specific authority and power to the Bankruptcy Court to award reasonable compensation for services performed, whether by creditors, representatives of creditors, or those bearing any other relationship to the proceedings. Furthermore, to hold that there is discrimination because one creditor might derive more in aggregate dollars by his investment for the reason that he has invested more, is to imply that regardless of such investment all creditors must receive the same aggregate dollar value, irrespective of the amount or volume of their claim.

3. That a holding that the plan of composition should make disclosures as to the nature, extent and circumstances surrounding the acquisition of claims of a creditor who seeks the consent of other creditors to such Plan, is directly contrary to the express provisions of Section 83 (a) of the Act, which sets forth what the petition and the Plan shall contain.

4. That a holding that it must affirmatively appear that there was a full and complete disclosure of a creditor's interest to other creditors, whose consents are solicited, before such consents may be said to be fairly obtained, is to write into the Act that which is not there, is to lay down a requirement not heretofore found in a single adjudicated case, and is likewise contrary to the decision in *Vallette vs. City of Vero Beach*, 104 F. (2) 59, 124 A. L. R. 686, to which this Court denied certiorari, 84 L. Ed. 87, 60 Sup. Ct. 110, and to comply with which the proceedings in the cause at bar were specifically

amended. Furthermore, such holding as to complete disclosure violates every rule of orderly pleading to arrive at issues, inasmuch as no such issue was raised in the pleadings of the recalcitrant creditor, but on the contrary, its amended answer specifically alleged details of such interest showing that it had full and complete knowledge and notice (R. 71). Furthermore, the interest involved was represented by judgments assigned of record, which assignments were voluntarily produced in open court (R. 151, 152), the full circumstances of their acquisition fully disclosed (R. 169, 202), the price paid therefor revealed (R. 178), all of them having been purchased prior to any bankruptcy proceedings (R. 170-171), and the substantial portion thereof having been owned even prior to the execution of any fiscal agency contract (R. 169). Thus it is that all creditors who were parties to the cause had full knowledge of all circumstances, not one sought to withdraw his consent, and the only complaining creditor knew all of the facts, as disclosed by its answer. Somewhere there is still left the principle of estoppel by judicial conduct. Furthermore, the "benefit" to be derived by R. E. Crummer & Company for special services which it alone rendered, was specifically stated in the Plan, its "profit", in the event there was a rising market from its legitimate investment in Avon Park securities, was subject to immediate mathematical calculation, and in fact the original petition filed contained all consents of it and its affiliated company on all the judgments and securities owned, which constituted notice to the world as to its interest as a creditor. Of this interest, no one complained but the petitioning creditor, who had full knowledge. It is apparent therefore that both the courts below fulfilled their full duty in allowing the inclusion of the vote of the claims held by this company after full and complete disclosure of all the circumstances involved.

5. That the record is uncontradicted that no securities involved were either purchased or sold during or in contemplation of the bankruptcy proceedings (R. 169, 170, 171); and the assignments of the judgments involved affirmatively showed such fact, but petitioner did not see fit to include them in the record.

6. That the implication that there was any "control" by the City of the securities owned and held by any creditor is contrary to the very record itself, which negatives such control (R. 177), and which affirmatively shows that the "claimant's assent to the plan" clearly reflected not the City's desires, but solely and only "an expression of an investor's independent business judgment", (R. 193, 208); and based upon such evidence, the Master specifically found the acceptances to have been in good faith (R. 224), which was specifically confirmed by appropriate findings by the District Court (R. 240, 244, 245, 247).

7. That the implication concerning any illegality in the fiscal agency contract is contrary to the specific holding of validity in the latest decision of the Supreme Court of Florida in the case of *State vs. City of Fort Myers*, decided November 22, 1940, certified copy of which was immediately furnished this Court; and likewise, any implication with reference to an injunction by a taxpayer enjoining the issuance of the new bonds, or the levy of assessments therefor, is contrary to the record, which affirmatively shows not only in the Plan itself (R. 88), but by uncontradicted testimony (R. 200) that the refunding bonds in contemplation have been authorized and duly validated. (R. 200.)

8. That the implication in foot note 5 that there were other emoluments to be derived by the Fiscal Agent by virtue

of the provision in the contract granting exclusive authority for a period of three years is contrary to the specific terms of the contract itself, which was for a period of one year, unless the Fiscal Agent had obtained the consent of holders of seventy-five per cent or more of the bonds to be refunded to participate in the plan of refunding (R. 36); the contract was dated July 17, 1937, and petitioner has specifically admitted in its brief that the seventy-five per cent requisite to a continuation of the contract had not been obtained. (Petitioner's Brief, p. 23). Thus it is that the contract is utterly immaterial except insofar as, pursuant to it, services were rendered antecedent to the development of the modified plan of composition, which was ultimately confirmed, and for which services the creditor theretofore acting as Fiscal Agent would be entitled to just and reasonable compensation under the express provisions of Section 83 (j). See also *Vallette vs. City of Vero Beach*, supra.

9. That in holding that the "speculative position in such of the interest accruals as it might acquire from the bondholders at one-third of their face amount" might bring about excess benefits discriminating in favor of the creditor so purchasing the same, the said provision is wholly optional with each creditor who must be presumed to know the value of its securities, and such holding presupposes a rising market and a profit, and overlooks entirely the absolute right of any creditor to purchase at the same figure or a lesser figure, if anyone is willing to sell.

10. That in holding that the provision with reference to disregarding claims "owned, held, or controlled" by the City was aiming at any abuse is to inject into the Act that which is not there, and to overlook entirely that the sole purpose of such provision was to specifically provide that securities which

had been acquired or retired by the debtor could not be used in the computation involved.

11. That the holding that the Fiscal Agent was acting in a dual capacity in representing the City and purporting to represent the interest of hondholders is contrary to the whole intent and purpose of the original fiscal agency contract, and is contrary to the very basis upon which proceedings such as these must rest, namely, cooperation and identity of interest and objectives between the debtor and the majority of its creditors.

12. That a reading of the entire record will affirmatively disclose the utmost good faith of the City and the creditor assisting it in working out its debt problem, a full disclosure in the testimony of all requisite and pertinent facts, a consideration thereof by the Court, and all elements necessary to constitute fair dealing.

WHEREFORE, Respondent respectfully and earnestly urges this Court to not remand this cause and thus bring about the utter chaos that will result by its being denied the benefits of the Act against those very creditors who made the enactment of the statute essential.

Respectfully submitted,

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ROBERT J. PLEUS,

Orlando, Florida.

*Attorney for Respondent.*

## CERTIFICATE OF COUNSEL

The undersigned, counsel for Respondent, does hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay.

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ROBERT J. PLEUS.

P. 7,

# SUPREME COURT OF THE UNITED STATES.

No. 31.—October Term, 1940.

American United Mutual Life Insurance Company, Petitioner, *vs.* City of Avon Park, Florida. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[November 25, 1940.]

Mr. Justice Douglas delivered the opinion of the Court.

The District Court confirmed a plan for the composition of the debts of respondent under Ch. IX of the Bankruptcy Act (50 Stat. 653; 52 Stat. 939, 940).[1] The Circuit Court of Appeals affirmed that order. 108 F. (2d) 1010. Petitioner, a creditor of the city, having objected to the confirmation in the courts below, brought the case here on a petition for certiorari, which we granted in view of the importance of the problems in the administration of the composition and reorganization provisions of the Act.

The city's composition was a refunding plan worked out by it and its fiscal agent,[2] R. E. Crummer & Co. Pursuant to the fiscal agency contract both parties were to use their best efforts to induce the creditors to participate in the plan. The city was not to pay any of the costs of the refunding, as Crummer was to defray all expenses incident to assembling the bonds, printing the refunding bonds, representing the city in proceedings to validate the new bonds, obtaining a legal opinion approving the bonds, *etc.* The fiscal agency contract provided that Crummer was to be compensated for its services and reimbursed for its expenses by assessing charges against the participating bondholders. This charge was $40 for each $1000 bond; or in case the bondholders elected to sell Crummer the interest

[1] The Act of August 16, 1937 (50 Stat. 653) under which the petition was filed expired June 30, 1940, except in respect to proceedings initiated on or prior to that date. That Act, however, was amended by the Act of June 28, 1940 (No. 669, 76th Cong., c. 438, 3d Sess.) which, *inter alia*, extended for another two years the time for filing petitions.

[2] R. E. Crummer & Co. is a Delaware corporation organized primarily to represent clients of an affiliate (see *infra*, note 4) who had purchased bonds in Florida. Beginning in 1931, it had handled the debt problems of over 200 taxing units.

coupons, accrued to July 1, 1937, at one-th rd of their face amount,[3] the charge was to be $20 per $1000 bond.

Crummer solicited assents to the plan. Approximately 69% of the bondholders accepted. But for the claims held by the Crummer interests,[4] and voted in favor of the plan, the requisite two-thirds statutory vote, however, would not have been obtained. Some of these claims had been purchased prior to the fiscal agency con act, some later. The average price was apparently about 50¢ on the dollar. The inference seems clear that some of them were acquired in order to facilitate consummation of the composition by placing them in friendly hands. But the record does not show whether or not Crummer disclosed to the bondholders when their assents were solicited that it was a creditor as well as the city's fiscal agent, the extent of the claims held by it and its affiliate, the circumstances surrounding their acquisition, and its intent to vote those claims in favor of the plan. No such disclosure was made in the plan.

The District Court, however, found that the two-thirds of the aggregate amount of claims affected by the plan, required by § 83(d), 11 U. S. C. § 403(d), for confirmation, had assented. It also found that Crummer's compensation was fair and reasonable, that the plan and its acceptance were in good faith, and that the plan

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[3] Under the original plan all such accrued interest coupons were to be acquired by Crummer at 33⅓% of the face amount, which when refunded into new bonds, would be held by it subject to purchase by the City at not exceeding 50% of the face thereof for the first six months, 60% for the succeeding six months, 70% for the next six months, and 75% for the following six months. Due to fears of illegality, the plan was modified. As modified it provided that compensation of the fiscal agent was to be 4% of the principal debt with the right of any creditor to sell to Crummer the interest accruals at 33⅓% of their face amount. In the latter event the charge against him was reduced to 2% and Crummer held the securities so obtained subject to the right of the city to acquire them at the rates above indicated. The fiscal agent estimated that it would get substantially the same amount of money out of the plan whichever option the bondholders elected.

Interest accruals were to be escrowed. Proceeds of the collection of delinquent taxes were to be remitted to the escrow agent who would reduce the amount owed by the city under the escrow by such amount as would result in the particular proceeds constituting a *pro tanto* payment and discharge at 50% of par during the first six months, 60% during the next six months, 70% during the next six months, and 75% during the following six months.

Thus in effect the interest accruals could be offset against delinquent taxes, the city being able to retire some of its debt at less than par if it could stimulate tax collections. The proceeds received by the escrow agent were to be held for the benefit of the depositors.

[4] R. E. Crummer & Co. and Brown-Crummer Investment Co. R. E. Crummer was president of both. A majority of the boards of both corporations was identical. The Crummer interests had acquired over a third of the claims.

was fair, equitable and for the best interests of the creditors, and did not discriminate unfairly in favor of any creditor.

We disagree. The order of confirmation must be set aside. It cannot be said that the plan does not discriminate unfairly in favor of any creditor, that the acceptances were in good faith, that the requisite two-thirds vote of approval had been obtained.

Crummer had at least[5] three financial stakes in this composition: (1) the fee to be collected from the bondholders; (2) its speculative position in such of the interest accruals as it might acquire from the bondholders at a third of their face amount; (3) the profit which might accrue to it or its affiliate, as a result of the refunding, on bonds acquired at default prices.

The court found that the first of these items was reasonable. But it apparently deemed the others irrelevant to the inquiry.

Clearly, however, no finding could be made under § 83(b), 11 U. S. C. § 403(b), that the compensation to be received by the fiscal agent was reasonable without passing on the worth of the aggregate of all the emoluments accruing to the Crummer interests as a result of consummation of the plan. Since that inquiry would necessitate an appraisal of the fiscal agent's speculative position in the plan, perhaps the definitive finding demanded by the Act could not be made. Yet that is a chance which the fiscal agent, not the bondholders, must take; for it is the agent who is seeking the aid of the court in obtaining one of the benefits of the Act. Moreover, to the extent that the aggregate benefits flowing to the Crummer interests exceeded reasonable compensation for services rendered, their reward would exceed what the court could authorize under § 83(b), 11 U. S. C. § 403(b). Furthermore, if any such excess benefits would accrue to them, then the plan would run afoul of § 83(e)(1), 11 U. S. C. § 403(e)(1). For in that event the plan would discriminate unfairly in favor of the Crummer interests as creditors.

Hence the lack of that essential finding would be fatal in any case. It is especially serious here in view of the fact that without the vote

[5] There were other emoluments for Crummer. It was granted "exclusive authority" to act for and on behalf of the city for a period of three years "in all matters connected with, or relating to, the exchange." And in case any bonds or coupons were presented for payment or suit instituted thereon the city agreed to give Crummer notice before any terms of settlement were agreed upon. These provisions, the fact that the Crummer interests hold large blocks of claims acquired at default prices, the likely interest of Crummer in the accrued coupons and its strategic position all point towards future speculative possibilities which are not inconsiderable, whatever may be said of their unhealthy impact on the city and the public investors alike.

of the fiscal agent the requisite two-thirds acceptance would not have been obtained. Where it does not affirmatively appear that full and complete disclosure of the fiscal agent's interests was made to the bondholders when their assents were solicited, it cannot be said that those assents were fairly obtained. Cf. *Rogers* v. *Guaranty Trust Co.*, 288 U. S. 123, 143. And where without such disclosure the fiscal agent's vote was cast for acceptance of the plan, it cannot be said that such acceptance was in "good faith" within the meaning of § 83(e)(5), 11 U. S. C. § 403(e)(5). Here the fiscal agent was acting in a dual capacity. While it was representing the city, it likewise purported to represent the interests of bondholders. The very minimum requirement for fair dealing was the elementary obligation of full disclosure of all its interests. And the burden was on it to show at least that such disclosure was made. Equity and good conscience obviously will not permit a finding that an acceptance of a plan by a person acting in a representative capacity is in "good faith" where that person is obtaining an undisclosed benefit from the plan.

We have emphasized that full disclosure is the minimum requirement in order not to imply that it is the limit of the power and duty of the bankruptcy court in these situations. As this Court stated in *Securities and Exchange Commission* v. *United States Realty & Improvement Co.*, 310 U. S. 434, 455: "A bankruptcy court is a court of equity, § 2, 11 U. S. C. § 11, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act. . . . A court of equity may in its discretion in the exercise of the jurisdiction committed to it grant or deny relief upon performance of a condition which will safeguard the public interest." And see *Pepper* v. *Litton*, 308 U. S. 295, 304, *et seq.* These principles are a part of the control which the court has over the whole process of formulation and approval of plans of composition or reorganization, and the obtaining of assents thereto. As we said in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 114, "The court is not merely a ministerial register of the vote of the several classes of security holders." The responsibility of the court entails scrutiny of the circumstances surrounding the acceptances, the special or ulterior motives which may have induced them, the time of acquiring the claims so voting, the amount paid therefor, and the like. See *Continental Insurance Co.* v. *Louisiana Oil Refining Corp.*, 89 F. (2d) 333. Only after such investigation can the court exercise the "informed, independent judgment" (*National Surety Co.* v. *Coriell*, 289 U. S. 426, 436; *Case* v. *Los Angeles Lum-*

*ber Products Co., supra,* p. 115) which is an essential prerequisite for confirmation of a plan. And that is true whether the assents to the plan have been obtained prior to the filing of the petition or subsequent thereto. Where such investigation discloses the existence of unfair dealing, a breach of fiduciary obligations, profiting from a trust, special benefits for the reorganizers, or the need for protection of investors against an inside few or of one class of investors from the encroachments of another, the court has ample power to adjust the remedy to meet the need. The requirement of full, unequivocal disclosure; the limitation of the vote to the amount paid for the securities (*In re McEwen's Laundry, Inc.,* 90 F. (2d) 872); the separate classification of claimants (see *First National Bank* v. *Poland Union,* 109 F. (2d) 54, 55); the complete subordination of some claims (*Taylor* v. *Standard Gas & Electric Co.,* 306 U. S. 307; *Pepper* v. *Litton, supra*), indicate the range and type of the power which a court of bankruptcy may exercise in these proceedings. That power is ample for the exigencies of varying situations. It is not dependent on express statutory provisions. It inheres in the jurisdiction of a court of bankruptcy. The necessity for its exercise (*Pepper* v. *Litton, supra,* p. 308) is based on the responsibility of the court before entering an order of confirmation to be satisfied that the plan in its practical incidence embodies a fair and equitable bargain openly arrived at and devoid of overreaching, however subtle. Neglect of that duty is apparent here by inclusion of the vote of the claims held by the Crummer interests in computing the requisite statutory assents, without protection of the public investors through the requirement of full disclosure and of other appropriate safeguards. By the same token allowance of compensation to Crummer without scrutiny of Crummer's speculation in the securities does not comport with the standards for surveillance required of courts of bankruptcy before confirming plans of composition or reorganization or before making such allowances. The scope of the power of the court embraces denial of compensation to those who have purchased or sold securities during or in contemplation of the proceedings. As in case of reorganizations under former § 77B, the provision in § 83(b), 11 U. S. C. § 403(b), for allowance of "reasonable compensation" for "services rendered" necessarily implies "loyal and disinterested service in the interest of the persons" for whom the claimant purported to act. *In re Paramount-Publix Corp.,* 12 F. Supp. 823, 828.

Beyond that is the question of unfair discrimination to which we have adverted. Compositions under Ch. IX, like compositions under the old § 12, envisage equality of treatment of creditors. Under that section and its antecedents, a composition would not be confirmed where one creditor was obtaining some special favor or inducement not accorded the others, whether that consideration moved from the debtor or from another. *In re Sawyer*, Fed. Cas. No. 12,395; *In re Weintrob*, 240 Fed. 532; *In re M. & H. Gordon*, 245 Fed. 905. As stated by Judge Lowell in *In re Sawyer, supra*, "if a vote is influenced by the expectation of advantage, though without any positive promise, it cannot be considered an honest and unbiased vote." That rule of compositions is but part of the general rule of "equality between creditors" (*Clarke* v. *Rogers*, 228 U. S. 534, 548) applicable in all bankruptcy proceedings. That principle has been imbedded by Congress in Ch. IX by the express provision against unfair discrimination. That principle as applied to this case necessitates a reversal. In absence of a finding that the aggregate emoluments receivable by the Crummer interests were reasonable, measured by the services rendered, it cannot be said that the consideration accruing to them, under or as a consequence of the adoption of the plan, likewise accrued to all other creditors of the same class. Accordingly, the imprimatur of the federal court should not have been placed on this plan. The fact that the vast majority of security holders may have approved a plan is not the test of whether that plan satisfies the statutory standard. The former is not a substitute for the latter. They are independent. See *Case* v. *Los Angeles Lumber Products Co., supra*, pp. 114-115.

Since the cause must be remanded there are two other matters which should be mentioned. Sec. 83(d), 11 U. S. C. § 403(d), provides that in computing the statutory two-thirds vote necessary for confirmation of a plan all claims "owned, held, or controlled" by the city shall be excluded. So far as appears, the claims held by the Crummer interests were not owned by or held for the city. Yet it is by no means clear that they were not "controlled" by the city within the meaning of the Act. Claims held by a city's fiscal agent presumptively would seem to fall in that prohibited category. The abuse at which the Act is aimed is not confined to those cases where the holder of the claims is an agent

of the city within the strict rules of *respondeat superior*. Rather, the test is whether or not there is such close identity of interests between the claimant and the city that the claimant's assent to the plan may fairly be said to be more the product of the city's influence and to reflect more the city's desires than an expression of an investor's independent, business judgment. Here there was such a close identity of interests between Crummer and the city *vis-à-vis* the refunding as to raise grave doubts as to the propriety of allowing those claims to vote in any event. That, however, is a question for appropriate findings by the court should another plan be presented.

Petitioner also urges that the fiscal agency contract between Crummer and the city was illegal under the decisions of the Supreme Court of Florida in *Taylor* v. *Williams*, — Fla. —, 195 So. 175, — Fla. —, 195 So. 184, — Fla. —, 196 So. 214, and *W. J. Howey Co.* v. *Williams*, — Fla. —, 195 So. 181. Under § 83(e)(6), 11 U. S. C. § 403(e)(6), the court must be satisfied that the city "is authorized by law to take all action necessary to be taken by it to carry out the plan" before it may enter a decree of confirmation. Plainly that finding could not be made if it was clear, for example, that a taxpayer could enjoin the issuance of the new bonds or the levy of assessments therefor. The courts below did not pass on the applicability of these recent Florida decisions to this fiscal agency contract since they were decided after the Circuit Court of Appeals affirmed the order of confirmation. Nor do we undertake to decide the question in view of our disposition of the case. It is, however, a relevant inquiry to be made by the District Court as, if and when another plan of composition is presented, which directly or indirectly involves any such fiscal agency contract.

For the reasons stated we reverse the judgment below and remand the cause to the District Court for proceedings in conformity with this opinion.

*It is so ordered.*

A true copy.

Test:

*Clerk, Supreme Court, U. S.*